FILE COPY

FILED
NOV 30
CHARLES ELMORE

No. 289.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

WALTER W. TAYLOR.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

TRUMAN HENSON,
Attorney for Respondent,
26 Liberty Street,
New York, N. Y.

INDEX.

	PAGE
Opinions Below	1
Jurisdiction	1
Questions Presented	1
Statutes and Regulations Involved	2
Statement	2
Summary of Argument	6
Argument	7-26
I. The determination of the Commissioner was wrong on its face and entitled to no presumption of correctness; and, in any event, was proven to be wrong by the evidence introduced	7
II. The taxpayer introduced substantial evidence tending to prove no additional tax to be due; and, the Board not having decided such evidence to be insufficient, it cannot be said that the taxpayer failed to prove his correct tax liability	13
III. Even if the taxpayer's evidence that no additional tax was due were insufficient, still the Board should not have approved the Commissioner's plainly erroneous determination, but should have decided no additional tax to be due, or, in any event, have received the taxpayer's further evidence	18
Conclusion	26
Appendix	28

Citations.

Cases: PAGE

American Products Co. v. Refining Co., 275 Pa. 332, 337 22
Becker v. United States, 21 F. (2d) 1003 25
Bright v. Eynon, 1 Burr. 390, 395; 97 Reprint 365 22
Bruce & Human Drug Co., Appeal of, 1 B. T. A. 342 19
Citrus Soap Co. of California v. Lucas, 42 F. (2d) 372 24
Cohan v. Commissioner, 39 F. (2d) 540 24
Collin v. Commissioner, 32 F. (2d) 753 .... 8, 24
Commissioner v. Wright, 47 F. (2d) 871 21
Conrad & Co., Inc. v. Commissioner, 50 F. (2d) 576 24
Darcy, *et al.* v. Commissioner, 66 F. (2d) 581, 585; certiorari den. 290 U. S. 705 22
Dempster Mill Mfg. Co. v. Burnet, 46 F. (2d) 604 24
Dermott v. Wallach, 66 U. S. (1 Black) 96, 98 22
Eau Claire Book & Stationery Co. v. Commissioner, 65 F. (2d) 125 24
Ferguson v. Commissioner, 59 F. (2d) 893 .. 21, 24
Freuler v. Helvering, 291 U. S. 35, 51 24
Hemphill v. Commissioner, 25 B. T. A. 1351 8
Independent Ice & Cold Storage Co. v. Commissioner, 50 F. (2d) 31 ..... 24, 26
Index Notion Co., Appeal of, 3 B. T. A. 90 .. 20
Kendrick Coal & Dock Co. v. Commissioner, 29 F. (2d) 559 24
Kirkland v. Burnet, 57 F. (2d) 608 .....8, 11, 24
Lucas v. Ox Fibre Brush Co., 281 U. S. 115, affirming 32 F. (2d) 42 15

PAGE

Matern v. Commissioner, 61 F. (2d) 663 23
Nichols v. Commissioner, 44 F. (2d) 157 24
Old Mission Portland Cement Co. v. Commissioner, 69 F. (2d) 676, certiorari granted Oct. 8, 1934 (55 S. Ct.), not officially reported 23
Phillips v. Commissioner, 283 U. S. 589 14
Pittsburgh Hotels Co. v. Commissioner, 43 F. (2d) 345 24
Rhode Island Hospital Trust Co. v. Commissioner, 29 F. (2d) 339 24
Strother v. Commissioner, 55 F. (2d) 626, aff'd 287 U. S. 308 24
Texas Penn Oil Co. v. Commissioner, 28 B. T. A. 917 8
Underwood v. Commissioner, 56 F. (2d) 67 21, 24
United States v. Rindskopf, *et al.*, 105 U. S. 418 26
Virginia-Lincoln Furniture Corp. v. Commissioner, 56 F. (2d) 1028 21
Wyoming Investment Co. v. Commissioner, 70 F. (2d) 191 21

Statutes:

Revenue Act of 1926, c. 27, 44 Stat. 9, 110:
Section 1003 (U. S. C. App., Title 26, Sec. 1226) 28
Revenue Act of 1928, c. 852, 45 Stat. 791, 815, 818:
Section 111 ..... 28, 29
Section 113 29

Miscellaneous:

PAGE

Treasury Regulations 74, Art. 58 ..... 8, 29

Commissioner's Formal Acquiescences:
C. B. IV-1, p. 1 20
C. B. V-2, p. 2 20

Rule 30, B. T. A. 24, 30

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 289.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
v.
WALTER W. TAYLOR.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 6) is unreported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 70 F. (2d) 619.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 18, 1934, (R. 36). The petition for a writ of certiorari was filed August 14, 1934, and was granted October 8, 1934. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

Whether the Commissioner's determination that the taxpayer had additional income was wrong on its face,

and whether the decision of the Board of Tax Appeals was wrong in law in approving that determination.

Whether the circumstances relating to the theory upon which the case was tried in the Board of Tax Appeals constituted reversible irregularity.

Whether the taxpayer introduced competent evidence tending to show both that he did not have the additional income determined by the Commissioner, and that he had no additional income; and whether the decision of the Board of Tax Appeals was wrong in law in disregarding such evidence.

If the answers to all of the foregoing are in the negative, then whether the Circuit Court of Appeals erred in remanding this case to the Board of Tax Appeals for a new hearing, on the ground that the amount of income determined by the Commissioner and approved by the Board was incorrect.

Statutes and Regulations Involved.

The Statutes and Regulations involved are set out in the Appendix, *infra*, pp. 28-30.

Statement.

The Board of Tax Appeals made no separate findings of fact and only a memorandum opinion. A statement of the substance of all the evidence adduced, agreed to by counsel for the Commissioner and duly settled by the Board, appears in the record (R. 23-32).

In August, 1927, the taxpayer purchased, at a total cost of $96,030, all of the stocks of three small public utility operating companies and all of the assets of an unincorporated fourth public utility operating company,

and thereupon, and on September 1, 1927 (R. 25) (and not on October 13, 1927, as stated in the Board's memorandum opinion), incorporated the Allied Public Service Corporation as a holding company, to take over said four operating companies. He thereupon incorporated the unincorporated operating company, and thereupon, and on October 13, 1927, transferred the stocks of all four operating companies to said Allied Public Service Corporation, the holding company, in a non-taxable exchange,[1] and received in return all the stock of that corporation, to wit: 1,000 shares $6 no-par cumulative preferred, entitled to a prior $100 per share on liquidation and callable at $105; 2,500 shares Class "A" Common, and 5,000 shares Class "B" Common (R. 24, 25, 28). At the trial herein the taxpayer, who was the only witness called, was qualified as an expert witness (R. 24, 28, 29, 30), and testified that the value of the stock of the holding company was no greater than the aggregate of the stocks of said four operating companies, for the same were separated by other companies and, for that and other reasons, could not be operated more economically, nor at a greater profit, nor were the same more readily salable, under one ownership than under four (R. 27, 28, 29, 30, 31); that beginning in the late winter of 1927 and running to and beyond May, 1928, a large appreciation took place in the market price of public utility stocks and properties (R. 27, 28, 29, 30); that after making numerous unsuccessful attempts to sell the stocks of said four operating companies, said holding company was approached by another company which had an unusual need for properties of this precise size and location, which circumstance, together with said appre-

1. With the result that the taxpayer's cost basis for all the stock of the Allied Public Service Corporation was the same as the cost to him of the four small public utility companies.

ciation, made it possible in May, 1928, for said holding company to sell said stocks for $194,930.16; and such sale was accomplished (R. 25, 26, 27, 29, 30). Thereafter, and during the year 1928, the taxpayer sold his preferred stock in said holding company to that corporation for $99,000 (R. 25, 26).

In his income tax return for 1928, the taxpayer reported, as profit on such sale, the difference between $99,000, the sale price of the preferred, and $96,030, the cost of all of the stock (R. 26).

The Commissioner, thereafter, issued his deficiency notice to the taxpayer in which he finally determined the taxpayer's cost basis for his said preferred stock to be $48,771.16, or that proportion of $96,030, the cost of all of said stock, which was represented by a fraction the denominator of which was $194,930.16, the price for which said holding company sold the stocks of the operating companies in May, 1928, and the numerator of which was $99,000, the sum for which the taxpayer thereafter sold his preferred stock (R. 26). The taxpayer duly took his appeal, from said deficiency notice, to the Board of Tax Appeals (R. 2-6).

At the trial before the Board, counsel for the Commissioner and then counsel for the taxpayer orally agreed that if the value of all of the assets of the holding company (consisting of said stocks of said four operating companies), at the time the same were acquired from the taxpayer, was not in excess of the cost of said assets to the taxpayer, or $96,030, then there was no deficiency. The Board Member conducting the trial inquired of counsel for the Commissioner if he concurred in this statement and counsel for the Commissioner stated that he concurred.

The said oral stipulation of counsel and question by the Board Member and answer by counsel for the Commissioner do not appear in the transcript of the pro-

ceedings at the trial, but that the same took place is established by the affidavit of the taxpayer's counsel before the Board, William P. Jeffery (R. 17, 18), and one of the affidavits of taxpayer's accountant, Walter R. Bullock (R. 17), annexed to the motion for new trial and incorporated by reference in the petition to the Circuit Court of Appeals praying for review of the decision of the Board.

In accordance with such agreement, the taxpayer introduced only evidence addressed to proving the value of said assets as of said date (R. 23-32).

Thereafter, the Board made its memorandum opinion (R. 6-9) and decision (R. 9) that however well the taxpayer had proven that the value of all the assets of the Allied Public Service Corporation, at the time the same were acquired by it, was only $96,030, still that was only one term, the denominator, of a correct fraction to apply, for purposes of apportionment, against the cost of all of the stock; and that the taxpayer should have proven a proper numerator as well. The Board did not make any finding as to whether it was in fact practicable fairly to apportion the cost basis of all of the stock, but decided that because he had not shown any allocation different from that determined by the Commissioner, the taxpayer had failed to prove his case; and that the Commissioner's determination should, therefore, be approved.

Thereafter, the taxpayer moved for a new trial (R. 9-18), contending that he should not be penalized for failing to introduce further evidence when he refrained from offering the same by reason of said oral stipulation of counsel; and further contending that in any event it is common knowledge, of which Courts have taken, and the Board should take, judicial notice that preferred and common stocks do not appreciate at the same rate and could not have done so in the cir-

cumstances here; that by virtue of that fact the Commissioner's said determination was wholly erroneous, arbitrary and fanciful on its face as a matter of law, for the same was based upon a 1928 ratio which was no evidence of the 1927 ratio, but, rather, was conclusive evidence of what the 1927 ratio was not; that, therefore, the Commissioner's said determination was not entitled to any presumption of correctness and should not have been approved; and that the Board should grant a new trial at which to receive the evidence, described in the supporting affidavits and offered for production, to show that no fair apportionment of said total cost was practicable as of the date of the acquisition of said stock by the taxpayer, and to enable the Board to decide the appeal on the merits.

The Board denied said motion from the bench (R. 2); and the taxpayer appealed to the Circuit Court of Appeals for the Second Circuit, which reversed and remanded (R. 33-37).

Summary of Argument.

In this case the Government does not seriously contend that an additional tax in any such amount as that which has been collected from the taxpayer, was due on the merits. The Government does contend that even though the taxpayer had proved that he did not owe an additional tax so large as that asserted against him, the Board, nevertheless, committed no error in deciding that he owed the asserted tax. In support of this, the Government urges that the taxpayer was under the burden of proving not only that he did not owe the tax asserted, but also what his correct tax liability was; and in order to apply that proposition to this case,

assumes (without demonstrating) that the taxpayer failed to prove that he owed no additional tax.

While the Government cites no case holding a taxpayer's burden of proof to be so heavy, we contend that the fundamental fallacy in the Government's position lies in the assumption that this case involves that question.

In the first place, the Commissioner's determination was wrong on its face, and not entitled to any presumption of correctness, so that no question of burden of proof could arise. Again, the conduct of the trial upon the agreed but erroneous theory upon which the case was tried, constituted irregularity which should be corrected by rehearing.

Finally, and, as we submit, conclusively, the taxpayer did not fail in his proof either as to proving the Commissioner's determination to be wrong, or as to proving no additional tax to be due.

ARGUMENT.

I.

The determination of the Commissioner was wrong on its face and entitled to no presumption of correctness; and, in any event, was proven to be wrong by the evidence introduced.

In the year 1928 the taxpayer sold certain preferred stock for $99,000, and the question herein is the cost basis to be used by him in computing his profit on said sale. Said preferred stock was acquired by the taxpayer, together with all of the common stock in the same corporation, for $96,030 in a lump sum transac-

tion without any allocation of the total cost between the common and preferred.

The Statute, as pointed out in the opinion below, contains no provision for an allocation of cost in the event of partial realization, but the Commissioner has promulgated a Regulation which prescribes that where common stock is received as a bonus with a purchase of preferred, the total price shall be fairly apportioned between the respective classes, but that if such fair apportionment be impracticable in any case, no profit upon any sale of any of the stock is realized until the total cost shall have been first recovered.

If this Regulation does not state the law as applicable to this case, then the taxpayer, by proving the total cost, and the sale price of the preferred, has unquestionably proven that he did not owe the tax asserted against him and also that he did not owe any additional tax.

If the Regulation referred to does state the law as applicable to this case, then the first question to be determined is whether it was practicable fairly to apportion a part of the cost of all of the stock to the preferred, and, if so, then what part of such cost should be so apportioned. It has been held by the Circuit Courts of Appeals and the Board of Tax Appeals that the Regulation referred to states the law as applied to cases such as this.[2]

---

2. Regulations 74, Art. 58, *infra* p. 29;
Collin v. *Commissioner*, 32 Fed. (2d) 753 (C. C. A. 6);
Kirkland v. *Burnet*, 57 Fed. (2d) 608 (App. D. C.);
Texas Penn Oil Co. v. *Commissioner*, 28 B. T. A. 917;
Hemphill v. *Commissioner*, 25 B. T. A. 1351.

In August, 1927, the taxpayer purchased four small public utility companies.[3] On September 1, 1927, he organized a holding company, and, having in the meantime incorporated one of the operating companies, which had been unincorporated, he conveyed the stocks of the four to the holding company and received all of its stock in exchange on October 13, 1927. This stock consisted of 1,000 shares of no-par preferred and 7,500 shares of no-par common. The preferred was entitled to cumulative dividends of $6 per share, was callable at $105, and was entitled to a prior $100 per share, or a total of $100,000, on liquidation.

In order to make an allocation to the preferred of a part of the cost of all of the stock, the respective values of the preferred, and of all the stock, as of the date of the taxpayer's acquisition thereof, must be found. The purchase of the four small operating companies and the transfer of their stocks to the holding company in exchange for all of its stock having been one continuous transaction, and the taxpayer having been the sole stockholder throughout, his acquisition of the stock of the holding company relates back to the acquisition of the operating companies. The operating companies were purchased for a total consideration of $96,030 in arms' length transactions (R. 24), and this established the value of all of the stock of the holding company as of the date of acquisition thereof by the taxpayer, and, consequently, established a denominator for a fraction of allocation to be applied against the same amount of $96,030 to determine what proportion thereof was properly allocable to the preferred stock as its cost basis.

But no numerator for such a fraction can be found.

---

3. Although both the Government's brief and the opinion of the Board state that the taxpayer had theretofore acquired options, such statements are without any foundation in the evidence.

The Commissioner, who had audited the taxpayer's, and the holding company's, records and return, had full knowledge of all of the facts. He knew that there were no sales of any of the stock of the holding company at any time prior to the sale of the preferred, and that the operating companies had declared no dividends. Moreover, he had the returns of the operating companies themselves, and therefore knew their full financial histories. But the Commissioner was unable to find, and, as we submit, the record discloses that there cannot be found, a numerator for such a fraction.

In spite of the fact that it was apparent that no fair allocation was practicable, the Commissioner, nevertheless, purported to make an allocation. In May, 1928, the holding company sold the stocks of the operating companies, which had been worth a total of $96,030 at the date of the taxpayer's acquisition of the stock of the holding company, for $194,930.16, thus establishing that amount as the value of all of the stock of the holding company as of that date, and, consequently, as a denominator for a fraction which, if supplied with a proper numerator, would state the proportionate value of the preferred to all of the stock as of that time. The sale of the stock of the operating companies by the holding company was followed by the sale by the taxpayer of his preferred stock for $99,000, and thus the proportionate value of the preferred to all of the stock was established, as of that date, as $\frac{99,000}{194,930.16}$. That ratio had no relation to a fair allocation as of the date of the taxpayer's acquisition of the stock of the holding company, but the Commissioner, nevertheless, purported to determine that the ratio between the preferred and all of the stock as of that date was the same as the ratio as of May, 1928, or $\frac{99,000}{194,930.16}$.

In this, the Commissioner committed an error of law, for not only was the ratio of 1928 no evidence of the 1927 ratio, but, on the contrary, the later ratio was conclusive evidence of what the ratio of 1927 was not.

Kirkland v. *Burnet,* 57 F. (2d) 608 (App. D. C.).

The Government does not question the correctness of the holding of the *Kirkland* case that common and preferred stocks do not appreciate at the same rate. Yet that case involved precisely the same question as the instant case, except that there it was stipulated that if the later ratio could not be said to establish the earlier, then it was impracticable to establish the earlier ratio. The Government mentions that stipulation as a controlling distinction, but it is submitted that the distinction is merely between the relief appropriate in that case and this. There the Court properly reversed without remanding. Here, the Court held the evidence of impracticability of apportionment not to be sufficiently conclusive to enable it to reverse without remanding.

The taxpayer's contention is not, as suggested in the Government's brief, simply that neither the value of $99,000, for the preferred, nor $194,930.16 for all of the stock, had any relation to the date of acquisition by the taxpayer of his stock in the holding company, although, of course, such is the case; we urge that the increase in the value of the assets of the holding company from $96,030 to $194,930.16 must have resulted in a much greater increase in the value of the common, than in the preferred. At the earlier date the total assets of the corporation were insufficient either to retire the preferred or to satisfy it upon liquidation. At that time, if, for purposes of the point, we concede any value to the common, it must have been not only un-

ascertainable, but in any event very small. At the later date, on the other hand, the assets of the corporation were sufficient to have retired the preferred, or satisfied it on liquidation, and still leave nearly as much again for the common.

There is no scintilla of evidence in the record tending to show that the ratio of the preferred to all of the stock of the holding company at the date of the taxpayer's acquisition thereof, was $\frac{99,000}{194,930.16}$, as decided by the Board. The evidence did establish $\frac{99,000}{194,930.16}$ to be the ratio as of May, 1928, but by that very fact established that fraction not to state the ratio of August, 1927.

In the petition for certiorari, the Government contended that the fact that the four operating companies were grouped under one management made the stock of the holding company more valuable than the aggregate of the four operating companies, but this, as pointed out in our brief in opposition to certiorari, was exactly contrary to the evidence, and the point appears to have been abandoned in the Government's brief on the merits.

The determination of the Commissioner of Internal Revenue in this case was entitled to no presumption of correctness, because it was wrong on its face. The exercise by the Commissioner of his discretion is entitled to weight; but where the Commissioner makes a groundless, capricious, or arbitrary determination, or one erroneous on its face, such determination is not the exercise of the Commissioner's discretion, but a failure to exercise it. Such a determination is not entitled to any presumption of correctness, nor to any *prima facie* weight. It is a mere contradiction in terms to say that a determination wrong on its face is presumptively correct. No court would grant a judgment by default if

the complaint stated no cause of action; yet, even assuming (contrary to the fact) that there was a default, that is precisely analogous to what the Board did here.

The decision of the Board in this case was not supported by any evidence, nor by any presumption. It was directly contrary to competent, uncontradicted evidence, the sufficiency of which was not questioned. The Board made the same error of law made by the Commissioner: its conclusion did not follow as a matter of law from its premise.

II.

The taxpayer introduced substantial evidence tending to prove no additional tax to be due; and, the Board not having decided such evidence to be insufficient, it cannot be said that the taxpayer failed to prove his correct tax liability.

The Government makes no serious contention that the taxpayer failed to sustain the burden of proving the determination of the Commissioner to be wrong. It rests its case upon the proposition that no matter how wrong the Commissioner's determination was, and no matter how wrong the Board was in redetermining the determination of the Commissioner, still it cannot be said that the Board erred as a matter of law, so long as the taxpayer failed to prove at the trial precisely what his correct tax liability was, in addition to proving that it was less than the amount determined by the Commissioner.

While, as we will hereinafter urge, the Government has not shown the requirement of the law to go as far,

nevertheless that question is not raised in this case. The taxpayer unquestionably proved the determination of the Commissioner to be wrong, and he introduced substantial evidence tending to show that he owed no additional tax.

This is not a case of failure of proof of correct tax liability, as contended by the Government. Although, pursuant to the agreed theory of the case, the taxpayer refrained from introducing all of the evidence he might otherwise have introduced, and although the evidence which was introduced was, as pointed out in the Government's brief, addressed to the issue which (as we contend the record establishes) had been stipulated to be the only issue, nevertheless that evidence also tended to show that it was impracticable to make any allocation between the preferred and all the stock of the holding company as of the time of the issuance of that stock. If sufficient, that evidence would have satisfied such burden of proof of his correct tax liability as the taxpayer may have had, for it would have established no tax to be due. The Board was the sole judge of the sufficiency of such evidence,[4] but, by reason of the error of its decision that the Commissioner's allocation was correct, the Board did not decide whether or not the evidence established that no fair allocation was practicable.

The Board decided the Commissioner's allocation to be correct. While it did not in terms hold any fair allocation to be practicable, it may be said to have held, by implication, that the Commissioner's allocation was both fair and practicable, and, by further implication, that the taxpayer's evidence of impracticability was insufficient. But the Board decided by implication only

---

4. *Phillips* v. *Commissioner*, 283 U. S. 589, 600.

what was necessary to its decision, and the decision that the Commissioner's allocation was correct was based upon an error of law. The implications of that erroneous decision, therefore, partake of equal error. The Board did not decide that any allocation other than that made by the Commissioner was either fair or practicable, and therefore did not hold, except erroneously in law, that the taxpayer's evidence of impracticability was not sufficient.

Lucas v. *Ox Fibre Brush Co.*, 281 U. S. 115, affirming 32 F. (2d) 42 (C. C. A. 4).

The Board not having held the taxpayer's evidence of impracticability not to be sufficient, it cannot be said that the taxpayer has failed to meet whatever burden he may have had of proving his correct tax liability.

The Court below, it is true, did state in its opinion that, "If the burden of proof goes so far as to demand not only that the taxpayer show that the deficiency assessed against him is wrong, but what is the proper deficiency, or that there should be none at all, the decision was right, even though we know that the tax is too high." This dictum of the Circuit Court of Appeals, taken in its context, which is a discussion of some of the evidence tending to prove impracticability of allocation, does not mean that the Court thought that there was no substantial evidence of impracticability introduced before the Board; it simply indicates a refusal on the part of the Circuit Court to say that the evidence introduced was of such weight as to allow the Court to reverse without remanding, on the ground that the Board could not have failed to find that no allocation was practicable.

The fact is that this is not a case of failure of proof; but a case where, by reason of a mistake of law, the Board disregarded competent evidence.

The whole record in this case tends to show that no apportionment was practicable. The taxpayer owned all of the stock at the outset, and he held the preferred throughout the period in question. Nothing appears in the record to rebut the presumption that he continued to hold all of the common, and, therefore, it appears from the record that there were no sales to evidence respective values for the different classes of stock.

Moreover, the record contains unqualified and uncontradicted testimony that during the time from August, 1927, to May, 1928, the operating companies declared no distributions or dividends (R. 31).[5]

The Board's error of law in disregarding this evidence cannot be questioned, for it stated in its opinion (R. 9) that there was no testimony as to this fact.

While the taxpayer, if it had not been for the stipulation of counsel agreeing to the erroneous theory of the case, might well have introduced cumulative evidence in this regard, at least it cannot be said that the record contains no substantial evidence that it was impracticable to apportion. Surely the Government does not intend to urge that the erroneous theory upon which the case was tried is any reason why the evidence introduced should not be given its full weight and meaning.

The taxpayer contends in this connection that an inference should be drawn from the determination of the Commissioner. The objection of the Circuit Court of Appeals to the finality of the taxpayer's evidence of impracticability was that the financial histories of the operating companies had not been shown. The Com-

5. The record shows (R. 31) that the earnings of the operating companies were between nine and ten thousand dollars a year, though whether this was gross or net did not appear. However, the evidence does indicate that the holding company had substantial expenses, for it employed a firm of supervising engineers (R. 29).

missioner, in making his determination, however, had all of the facts which the taxpayer could have had, for he must have had the income tax returns of the operating companies, and must be presumed to have satisfied himself as to their correctness by audit or otherwise. The Commissioner had fully audited the taxpayer's return and examined his books and records. He had sent the taxpayer two audit letters, proposing additional tax, and had received the taxpayer's statements in protest thereto. The Commissioner was in possession of all of the facts; he must be presumed to have taken the most reasonable action which could be taken in the premises, for such was his duty. When the Commissioner, making the most reasonable allocation which the facts allowed, made an allocation without any foundation in fact and which was absolutely wrong on its face as a matter of law, it would appear proper to infer that no fair allocation could be made.

The Board of Tax Appeals held that the Commissioner's determination should be approved for the reason that the taxpayer had not shown any other allocation, thus assuming (without the support of any evidence or presumption) that some fair allocation was practicable. Had the Board properly applied the law, its decision (passing, for the moment, the fact that the Commissioner's allocation was a mere nullity) would have been that the allocation made by the Commissioner was not a proper allocation, and the Board should then have decided whether any allocation was practicable. But it merely decided that the Commissioner's allocation was practicable, and this being erroneous, the Board has not decided the fundamental question, although evidence tending to show no allocation to be practicable was in fact introduced. The whole thesis of the Government's case is based upon a

failure of proof, but it is submitted that so long as the record contains evidence tending to show both that the Commissioner's determination was wrong and the correct tax liability, and the only decision of the Board has been the erroneous one that the Commissioner's allocation was correct, the foundation for the Government's case does not exist. It cannot be said that there has been any failure of proof, even though it be held that the taxpayer should have proven the correct amount of tax, as well as that the Commissioner's determination was wrong.

III.

Even if the taxpayer's evidence that no additional tax was due were insufficient, still the Board should not have approved the Commissioner's plainly erroneous determination, but should have decided no additional tax to be due, or, in any event, have received the taxpayer's further evidence.

The question argued by the Government, *i. e.*, whether the Board errs in law when it decides that because a taxpayer does not prove his correct tax liability he owes the tax asserted against him by the Commissioner, no matter how conclusively he has proven that he does not, is not presented in this case, because the taxpayer did not fail of his proof. But even if he had failed to prove he owed no additional tax, still that question does not appear.

As we have urged above, the determination of the Commissioner was wrong on its face. Being wrong on its face, it was entitled to no presumption of correctness. And being entitled to no presumption of correct-

ness, it could have raised no burden of proof upon the taxpayer.

When the Commissioner, in the exercise of his discretion, makes a determination, that determination is entitled to a presumption of correctness. Thus the need of the Government expeditiously to collect its revenues is served, but we know of no case suggesting such consequences to flow from a determination of the Commissioner based upon his failure or refusal to exercise his discretion.

Whether or not the Commissioner acting on some reasonable ground may, by a denial of the correctness of an item on the return of a taxpayer, force the taxpayer to come forward and prove that the item was correct not only in respect of the Commissioner's question, but also in all other respects, surely the mere caprice of the Commissioner can place no such burden on the taxpayer.

Like the decision of the Board, the only determination of the Commissioner that any fair allocation was practicable is one implied by his determination that the allocation he determined ought to be made. Inasmuch as that determination was wrong as a matter of law, it cannot be said that there has been any determination that any fair allocation was practicable.

The purported determination of the Commissioner having been merely arbitrary in this case, the correctness of the taxpayer's return has not been questioned and ought to be affirmed.

The Board of Tax Appeals has held that where the Commissioner's determination is wrong upon its face, it is a nullity; and that a decision approving the return should be entered.

Appeal of Bruce & Human Drug Co., 1 B. T. A. 342;

Appeal of Index Notion Co., 3 B. T. A. 90.

In both of these decisions, the Commissioner has formally acquiesced.[6]

But even if the Commissioner's determination were not arbitrary, still the fact that the case was tried by all upon a mistaken theory of law is an irregularity which should be corrected by reversing the decision of the Board and remanding for a new trial.

The Government admits in its brief that the case was indeed tried, by the taxpayer, exclusively upon the theory referred to, but states that the Commissioner denied that he had agreed thereto. This statment, however, appears to be based upon a misapprehension of fact.[7] The record contains two affidavits of reputable persons, one of whom was the taxpayer's attorney before the Board, and the other of whom, the taxpayer's accountant, was also present at the trial, stating, on knowledge, that such agreement took place. These affidavits stand uncontradicted on the record.

The only foundation for the statement, of which we are aware, is that in its brief in the Circuit Court of Appeals the Government did state that such agreement was "not admitted." Inasmuch as that statement does not appear upon the record, we ask leave to add that at the hearing before the Board on the taxpayer's motion for new trial, the Commissioner's counsel, who had conducted the trial, stated that he did not remember whether or not he had made such agreement.

It is submitted that the record establishes such agreement to have been made.

---

6. C. B. IV-1, p. 1;
C. B. V-2, p. 2.
7. This error was promptly called to the attention of the Government by letter dated November 21, 1934, to which reply was made that explanation or correction would be made in oral argument.

As stated in the affidavits of William P. Jeffery and Walter R. Bullock (R. 17, 18), the case was tried upon the theory, agreed to by the Commissioner, and tacitly approved by the presiding Member of the Board, that if it were shown that the value of the stocks of the operating companies, at the time the same were acquired by the holding company, did not exceed their cost to the taxpayer, then there was no additional tax.

This, it is submitted, amounts to prejudicial error which can be corrected only by a rehearing, for, had it not been for such agreement, the taxpayer might well have introduced at the trial the further evidence offered in his motion for new trial.

In *Wyoming Investment Co.* v. *Commissioner*, 70 F. (2d) 191 (C. C. A. 10), the facts as to trial upon an agreed but erroneous theory were almost identical with the facts in the instant case, and the Circuit Court of Appeals reversed and remanded. In that case, the Government states, no review was sought.

Even where there has been no agreement, but, through some misfortune or misunderstanding, or due to trial on an erroneous theory, the taxpayer has failed to prove his correct tax liability, the Circuit Courts have reversed and remanded; and this rule would appear to be particularly applicable where, as here, the Commissioner's determination was positively wrong and further evidence is available.

Underwood v. *Commissioner*, 56 F. (2d) 67 (C. C. A. 4);

Virginia-Lincoln Furniture Corp. v. *Commissioner*, 56 F. (2d) 1028 (C. C. A. 4);

Ferguson v. *Commissioner*, 59 F. (2d) 893 (C. C. A. 10);

Commissioner v. *Wright*, 47 F. (2d) 871 (C. C. A. 7).

And such has always been the duty of appellate courts.

> *Bright* v. *Eynon,* 1 Burr. 390, 395; 97 Reprint 365;
> *Dermott* v. *Wallach,* 66 U. S. (1 Black) 96, 98;
> *American Products Co.* v. *Refining Co.,* 275 Pa. 332, 337.

While we believe it to be clear that the question of the extent of the taxpayer's burden of proof does not arise in this case, we point out that no case cited by the Government goes so far as to hold that where, in a proceeding before the Board of Tax Appeals, the determination of the Commissioner has been established to be absolutely wrong, the Board may, nevertheless, decide it to be correct.

As pointed out in our brief in opposition to certiorari, while in some cases the Courts have indeed used language indicative of such a duty, the fact in each of the cases cited in the petition for the proposition that the taxpayer before the Board must prove the correct amount of tax, was that the taxpayer had not proven the Commissioner to be wrong. As we there suggested, the reason for the existence of such language appears to be that the most feasible disproof of one fact is, oftentimes, proof of a contrary fact. As illustrative of that point, we quoted from that part of the opinion in *Darcy, et al.* v. *Commissioner* (C. C. A. 2), 66 F. (2d) 581, 585, certiorari denied 290 U. S. 705, which was quoted in the petition (and repeated in the Government's brief on the merits), as follows:

> "The burden is upon the petitioners to show the correct amount of the tax *in order to show that the Commissioner's determination was wrong.* * * *"
> (Italics supplied).

As further evidence of that fact, we pointed out that *Matern* v. *Commissioner* (C. C. A. 9), 61 F. (2d) 663, cited by the Government in the petition (and its brief on the merits) for the same proposition, has been cited in a later case by the same Court for the proposition that:

> "* * * This court has held that 'the presumption of correctness is attached to the Commissioner's findings'. *Matern* v. *Comm'r.*, 61 F. (2d) 663, 666. So from the outset the determination by the Commissioner of the fair market value of the property in question was *prima facie* correct and the burden of establishing it as incorrect was upon the petitioner."
>
> *Old Mission Portland Cement Co.* v. *Commissioner* (C. C. A. 9), 69 F. (2d) 676, 679; certiorari granted Oct. 8, 1934, (55 S. Ct. 79) not officially reported.

In its brief on the merits the Government cites the same and other cases, but we submit that neither any case cited before, nor any cited for the first time in the brief on the merits, stands for any more than that the Board will be affirmed in approving the determination of the Commissioner, where the taxpayer has failed to prove that determination to be wrong.

On the contrary, as we pointed out in our brief in opposition, the Circuit Courts of Appeals for every Circuit and the Court of Appeals of the District of Columbia have held that where the determination of the Commissioner has been proven to be wrong, the Board may not approve the erroneous determination of the Commissioner on the ground that evidence sufficient to form the basis for a decision on the merits has not

been introduced.[8] In the Third Circuit, the rule has been laid down that where the determination of the Commissioner has been shown to be wrong, the Commissioner must show why the return should not be approved.[9]

Pittsburgh Hotels Co. v. *Commissioner, supra,* footnote 8;
Nichols v. *Commissioner, supra,* footnote 8.

In the other Circuits such cases are sent back for further facts, unless the evidence is sufficient to permit the Court to make a decision on the merits. See cases cited *supra,* footnote 8.

We have found no discussion of this question in any decision of this Court, except that, in his dissenting opinion in *Freuler* v. *Helvering,* 291 U. S. 35, in which Mr. Justice Brandeis and Mr. Justice Stone concurred, Mr. Justice Cardozo stated that by the decision in that case the taxpayer was relieved of proving the amount of the Commissioner's error; and said, at p. 51:

---

8. *Rhode Island Hospital Trust Co.* v. *Commissioner* (C. C. A. 1) 29 F. (2d) 339;
Conrad & Co., Inc. v. *Commissioner* (C. C. A. 1) 50 F. (2d) 576;
Cohan v. *Commissioner* (C. C. A. 2) 39 F. (2d) 540;
Pittsburgh Hotels Co. v. *Commissioner* (C. C. A. 3) 43 F. (2d) 345;
Nichols v. *Commissioner* (C. C. A. 3) 44 F. (2d) 157;
Strother v. *Commissioner* (C. C. A. 4) 55 F. (2d) 626, aff'd 287 U. S. 308;
Underwood v. *Commissioner* (C. C. A. 4) *supra;*
Independent Ice & Cold Storage Co. v. *Commissioner* (C. C. A. 5) 50 F. (2d) 31;
Collin v. *Commissioner* (C. C. A. 6) *supra;*
Eau Claire Book & Stationery Co v. *Commissioner* (C. C. A. 7) 65 F. (2d) 125;
Kendrick Coal & Dock Co. v. *Commissioner* (C. C. A. 8) 29 F. (2d) 559;
Citrus Soap Co. of California v. *Lucas* (C. C. A. 9) 42 F. (2d) 372;
Ferguson v. *Commissioner* (C. C. A. 10) *supra;*
Kirkland v. *Burnet* (App., D. C.) *supra;*
Dempster Mill Mfg. Co. v. *Burnet* (App., D. C.) 46 F. (2d) 604.

9. The burden of proof as to deficiencies not asserted in the original notice is on the Commissioner. B. T. A. Rules of Practice, Rule 30, *infra,* p. 30

> "* * * The Commissioner's assessment is supported by a presumption of correctness. If a taxpayer would overthrow it, he has the burden of proving it erroneous, and of fixing in dollars and cents the amount of the error. By the decision just announced, the taxpayer is relieved of that burden. * * *"

As we contend, the Board may not, without committing error, decide that a taxpayer owes a tax which he has proven he does not owe, at least where there is ground to believe that at another trial evidence, not theretofore introduced by reason of some mistake or misfortune, may be available in order to establish the true tax liability.

We submit that the distinction made by the Court below as respects the difference between suits for refund and proceedings before the Board of Tax Appeals concerning asserted deficiencies in tax, is correct. In a suit for refund, a taxpayer is asking a money judgment against the United States (or the Collector), and it is fundamental that to obtain such a judgment he must show every dollar that is due him.

In *Becker* v. *United States*, 21 F. (2d) 1003 (C. C. A. 5), as pointed out in our brief in opposition to certiorari, the taxpayer had reported its income upon a basis which, it was found, did not correctly reflect income. The Commissioner made an assessment on a basis, which, although not exact, was "as nearly accurate as it was possible to make from the company's books". In the *Becker* case, it did appear that the Commissioner's determination was erroneous to some extent, and the Court did, nevertheless, uphold it. It was so upheld, however, upon the basis that the Commissioner's determination was "as nearly accurate as it was possible to make from the company's books". As

contended in our brief in opposition to certiorari, the case presents a special situation, and the same Court subsequently decided *Independent Ice & Cold Storage Company* v. *Commissioner, supra,* without reference to it. In any event, the *Becker* case did not involve a proceeding before the Board, but before a court.

In *United States* v. *Rindskopf, et al.,* 105 U. S. 418, this Court, speaking through Mr. Justice Field, stated that, to the extent to which an assessment is not impaired by the evidence, it remains due. That case was a suit upon a distiller's bond founded upon an alleged tax due. It appeared that the defendant therein did establish that the entire amount of the assessment was not due, but did not establish that some part thereof was not due. It is significant to note that in the *Rindskopf* case this Court remanded for a new trial, as was done by the Court below in the instant case.

Conclusion.

In conclusion, it is respectfully submitted that where a taxpayer has proven that he does not owe the tax asserted against him, but the Board holds that sufficient evidence has not been introduced to serve as a basis for a decision on the merits, and approves the erroneous determination of the Commissioner, a Circuit Court of Appeals properly reverses the erroneous decision of the Board and remands the case for the taking of further evidence, at least where it appears that such evidence is available.

That question, however, is not raised in this case. The determination of the Commissioner was wrong on its face, and was a mere nullity which did not operate to question the taxpayer's return. Moreover, the case was tried under such circumstances that the decision of

the Board, without receiving the taxpayer's further evidence, was an irregularity which should be corrected by a rehearing.

And in any event, as we contend, the taxpayer did not fail in his proof either as to proving the Commissioner's determination to be wrong, or as to proving that he owed no additional tax.

The decision of the Board was erroneous in law. From the evidence in the record, the conclusion appears to be irresistible that the taxpayer did not owe an additional tax in any such amount as has been collected from him, or, indeed, in any amount. In any event, further and cumulative evidence in this regard is available and has been offered. It is submitted that the decision of the Court below was appropriate and just and correct in law; and ought to be affirmed.

Dated: New York, N. Y., November 28, 1934.

Respectfully submitted,

TRUMAN HENSON,
Attorney for Respondent,
26 Liberty Street,
New York, N. Y.

APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9, 110:

SEC. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require. (U. S. C. App., Title 26, Sec. 1226.)

Revenue Act of 1928, c. 852, 45 Stat. 791, 815, 818:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112. * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property: except that—

* * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. * * *

Treasury Regulations 74:

ART. 58. *Sale of stock and rights.* * * * Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost. * * *

Rules of Practice Before The United States Board of Tax Appeals:

Rule 30.—*Burden of Proof.* The burden of proof shall be upon the petitioner, except as otherwise provided by statute and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.